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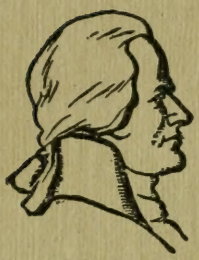
RECORDS THAT COUNSEL AND PROTECT

Records are a necessity and should be so planned that they develop the greatest usefulness.



MODERN BUSINESS
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Records That Counsel and Protect

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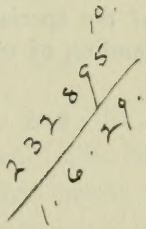
This Talk, to be read in connection with Volume 21, forms part of READING ASSIGNMENT 41



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READING ASSIGNMENT

The current Reading Assignment consists of three parts: (1) this Talk, (2) Part I of Volume 21, "Accounting Practice and Auditing", and (3) Lecture 21.

Accounting practice takes note of the essential things in business affairs, and a study of its methods sharpens the comprehension of what is essential. You may never have occasion to open or close accounting books, but you are as a business man interested in knowing that in your business they are correctly kept. By the study of the special cases discussed in Vol. 21, your understanding of vital business records will be broadened.

Records that Counsel and Protect

A profit must not be confused with a saving. No profit is realized nor is a sale effected until goods are transferred to outsiders and at an excess over cost.—Page 41, Chapter II, Part I, Volume 21, of the MODERN BUSINESS Text.

Is a king an inevitable necessity or a necessary evil? This is a question sometimes discussed in constitutional monarchies. Apply the same question to bookkeeping records. If the business man realizes that they are an indispensable requisite, he will know that they can be made a constructive force in his business, and he will see to it that they are made so complete that they will give him the greatest measure of assistance in forming his business policies. If he thinks such records a necessary evil he will neglect them, and probably rue the day.

Bookkeeping Bores Me

In business as elsewhere we find the happy-go-lucky man who never looks ahead. The books are a bore to him, and if they serve his needs as he sees them he is satisfied. He has no expectation of selling out, and needing books for proofs and demonstration. He is not thinking of taking in a partner, or of incorporating. It certainly does not occur to him that he may some day be summoned to produce his books in court at the instance of some partner, employe, in-

vestor, stockholder or, worst of all, some referee in bankruptcy, or that he may be glad to do so for his own protection. It is plain, however, from the fact that these things sometimes do happen, that a good deal more than a business man's income—his reputation, his honor, perhaps even his liberty—may be affected by the books and the manner in which he keeps them. But even if these untoward events do not happen, he stumbles along in business without a light unless his books are well and intelligently kept. He misses chances for profit and is very often ruled by his business instead of ruling it.

In the days before extradition treaties were common, Blake had a wholesale store from which he drew a comfortable living. He was a shrewd bargainer, and a hearty whole-souled chap whom everybody liked. He did not hesitate to say and to say frequently that he really knew nothing about his books; that he trusted implicitly his old bookkeeper, John Hawkins, who had been with him since the business started and who was a regular wizard. He was. One day he made a lightning change to South America and $20,000 of his employer's money went with him.

Involuntary Larceny

Of course no accounting systems are fool proof or burglar proof. It is not their primary function to prevent dishonesty, tho they may be useful in this direction. Some methods greatly impede embezzlements, others openly invite them. Had Blake kept

his ignorance to himself or, better still, had he attempted to dispel it, Hawkins might still be a respectable citizen, and Blake a wiser man without being a sadder one.

But do not think when the business is robbed that it is always the bookkeeper who does it. More often it is the employer who robs himself. He may have as a bookkeeper a man whose heart is honest but whose head is thick, or he may, and too often does, overrule a cautious bookkeeper and direct him to make entries which the accountant does not approve. A man who consciously or unconsciously swells the record of his assets beyond their real value lives in fools' paradise, and may wake up to find himself in the poor house.

A business man, moreover, who allows his books to be kept in a slovenly, ineffective manner, who does not learn to draw from them material assistance in conducting his business, may keep his capital intact, but is robbing himself of opportunity.

Enjoying the Picture

When you read some wretched verse in the newspaper you do not call in a poet to tell you it is doggerel. You do not have to be an artist to know that some of the thousand posters displayed in our streets are not art. Nor does the business executive need to be an accountant to know whether the records made for him are satisfactory and useful.

But if he does not know what his records ought to be, and what they can tell him, he may be at the mercy

of a bookkeeper of impeccable honesty and impenetrable stupidity. Accounting procedure may be more or less a foreign language to the business man, but accounting results should be his vernacular.

Now what are the results that the business executive needs for a proper conduct of his affairs? The present reading assignment deals with some of them. It makes no pretence to cover them all. Those selected for presentation are the most important and they embody the general principle that the accounting records should reflect accurately the actual conditions prevailing in any particular business, since only when this is the case do they become of constructive value to the owner or manager.

A Retrospect and an Outlook

The treatment of "Accounting Practice" in the MODERN BUSINESS Course is intended to intensify by special applications the principles covered by the Text on "Accounting Principles", and thus place the reader in a better position to analyze and interpret financial statements, which form the subject of the succeeding volume.

To accomplish this end the author takes up in detail the accounting records which disclose to the business man (1) what the business is worth, (2) who owns it and (3) how it is owned.

The first is concerned with the accurate statement of business assets, the second with a comprehensive and exact record of the mutual relations among joint owners, while the third considers cases when the

possessor of the goods is not in fact owner, but occupies a trustee capacity toward others.

What the Business Owns

Any business is worth the difference between its assets and its liabilities. This is the proprietorship. It would seem to be simplicity itself to determine its precise amount, a mere matter of addition and subtraction. There's no trouble with the operation, but there is often trouble with the items that enter into it.

There is little chance for error in stating liabilities. These are definite and precise obligations and the business man often sighs to think that they seem to be warranted nonshrinkable. The guarantee works against him, and he perhaps wishes that he had a like guarantee in his favor for his assets.

These too figure on the records as definite and precise sums of money, but they are not money, merely the money value placed upon a variety of tangible things and evidences of indebtedness. Are they valued rightly? Too often they are not.

This matter is so important that the author does not feel justified in going very deep into his subject before he has uttered a warning word in regard to the dangers of misinterpreting the facts, and of overexpansion of the business, which follow from inaccurate records.

Who Owns the Business?

When the sole proprietor takes in a partner, or when he is succeeded by a corporation, a new ques-

tion arises, who owns the business? This is not a question of accounting; it is one of facts. But unless the accounts record the facts in all their aspects trouble is sure to ensue.

The author discusses the various details of partnership accounts, when the business is started, while it lasts and when it ends. If the books are right at the start, and they can only be right with a properly formulated partnership agreement, accurately recorded, there will be little difficulty from an accounting standpoint in carrying on the business or winding it up if it comes to an untimely end.

The Small End of the Horn

Soon after the outbreak of the war in Europe, Tolman Bailey, proprietor of a machine shop in western Pennsylvania, called Rogers, his manager, and Tripp, his bookkeeper, into the office.

"Boys", he said, "I've been watching this war business develop and I think its about time we went after some of it. Such a chance may never come again. Now, you boys have stood by me for a good many years. You've helped build the business and I want to do something to show my appreciation. From now on you will be my partners here, with a sixth share each in the profits over and above your regular salaries."

As Bailey had calculated, the new partners took hold with a will. New business flowed in. Before the expiration of the year the little machine shop had

trebled in size and production. There is no telling how far the growth would have gone if the founder had not suddenly died.

"Tripp", said Rogers, the day after the funeral, "I suppose you have a record of Mr. Bailey's promise about the partnership?"

"Why, no, Rogers", answered Tripp, with a startled look. "Haven't you?"

"No", said Rogers, rubbing his head, "I haven't anything and I've looked all thru Mr. Bailey's desk and files. Probably it will show up in some other way."

No Records to Support the Claim

But it never did. In the probate proceedings to settle Bailey's estate Rogers and Tripp put forward their claims to a share in the business, but there were no records to support them.

"You have no letter or memorandum signed by Mr. Bailey?" asked the court, somewhat dryly. The manager had to confess his negligence in not having had the promise put in writing.

"And you made no bookkeeping entries to show the changed conditions of the business which you allege, Mr. Tripp?" the court asked later.

"N-n-no!" stammered the bookkeeper. It had just dawned on him that he had held his fortune in his own hands—and had allowed it to slip thru his fingers! Had he attempted to make a proper entry in his books, he would have asked for the necessary record, and the intangible promise of the employer

would in all probability have been reduced to a basis of solid fact. It was too late when he realized his negligence.

"Great Scott", he groaned, "and I thought I was a bookkeeper. I guess there's a lot to it that I know nothing about."

An Impromptu Partnership

Two young men, Powelson and Brown, struck up a friendship in the boarding-house where they first met. Powelson was a traveling salesman, Brown a dry goods clerk. After summering and wintering their acquaintance they decided to go into business together. Their combined resources fell short of a thousand dollars, but with the aid of generous credit obtained from a number of manufacturers, they were enabled to open an attractive little men's furnishing shop in a desirable locality. Powelson drew up a penciled agreement of partnership to run three years and they signed a lease of the store for that period.

The end of the first year saw the young men "treading water" with their chins just above the surface. There was hope, however, of reaching dry land eventually and they kept on.

One morning about this time Powelson arrived late.

"Sorry, old man, but I had to be away over night", he said in reply to his partner's injured stare. "I got word last night that I had come into a little inheritance—$12,000 left me by Uncle George."

"Great, Joe!" responded his partner. "I'm glad

to hear it. You'll have a chance now to get three 'squares' a day, anyway."

Possibly he expected Powelson to hook up the business and the legacy in a reference, but the latter failed to do so. When the matter was mentioned a few days later Brown got a shock.

A Partner Who Wouldn't Be Frozen Out

"Tom", said Powelson at last, "I've been thinking it over. I've got capital enough now, which neither of us had before. It's my big start and naturally I want to make the most of it. I can branch out, carry a much bigger stock and put the business on a paying basis. Without the slightest reflection on you, I feel that I would rather go it alone. How much is your interest in the business worth to you—how much will you take for it?"

"Why, this is a little sudden, Joe", said his partner, crumpling. "I was looking forward to a long stop here. They will probably start work on the new passenger station at the corner by fall; you saw the plans in the paper. Real estate and rentals are already beginning to jump. Our lease runs for two years longer. We got it cheap and it's worth big money today. Then see what the new station will add to our good-will. No, Joe, I just can't afford to quit now when our prospects are so bright."

"Then buy me out", said Powelson.

"You know I can't do that", returned Brown.

"Well, you see!" And Powelson shrugged his shoulders. "Tom", he continued, "we haven't the

capital to run the store; that's all there is to it. And we can't hang on until the tide turns. At least, I don't believe you can."

"All right", said Brown, crisply. "I'll sell. Return me my $400 original investment, give me $2,000 for my share of the good-will and the increased value of the leasehold and I'll quit."

Good-will that was Bad

Powelson remonstrated that Brown's figure was altogether too "fancy."

"Cut it in half", he said, "and I'm willing to close the deal now. That will leave you $1,000 ahead."

But Brown, having the whiphand, steadfastly refused to come down a single cent. In vain Powelson fumed. The more he was opposed, the stronger grew his desire for absolute possession, and by the operation of a natural law, the weaker became his appreciation of his cash in hand—there's a proverb that fits such cases—"Easy come, easy go." After a week of argument, he yielded and paid over to Brown the $2,400 demanded, justifying his course to himself with the assurance that it was worth that much to have a free hand.

A month later and "Powelson's Haberdashery" blossomed out with a larger and more resplendent stock. Two or three months more and then one morning the daily paper nearly brought heart failure. He had to read the headlines three times before he understood; the big railroad station was not to be

erected in that locality! It was to go half a mile farther down town.

"Good-bye to good-will and increased rental value", Powelson exclaimed, pounding his desk and stamping about in sudden fury. "Good-bye to my $2,000 and new stock!"

How Knowledge of Accounting Would Have Helped

There is no bookkeeping or accounting provision that will take the place of good "horse sense", but this much a knowledge of accountancy would have done for Powelson, if he had invoked it in the beginning: he would have insisted upon an adequate partnership agreement which, among other things, would have anticipated a possible future change in ownership and fixed upon a method of valuing the good-will and leasehold in that event.

Operating the Partnership

The illustrations show that if the partnership is to be properly managed and equitably terminated there are many details which must be carefully provided for in advance. Unless the partners record their intentions the accounting records cannot express them in the operation of the business.

Allowance of interest on capital, for example, may be the only means of equalizing the returns of the partners, yet unless this has been provided in the partnership agreement, it cannot be recorded in the books. How these allowances are made, whether thru the operating accounts or thru the partners' ac-

counts only, may have a considerable effect on operating profits. Again there are cases when additional funds put into the business by a partner should be regarded simply as loans, rather than as additional capital. These are matters to be carefully considered when the partnership agreement is drawn up.

The supreme test of the adequacy of the partnership agreement comes, as our illustrations have plainly shown, when for one cause or another the partnership comes to an end.

Forcing the Result

Do you remember how, when you were a school boy, you discovered that there were such things as arithmetic books which contained the answers? Perhaps you remember, too, how you sometimes forced the problems to give the answers, hoping that the fraud would not be discovered.

There is an unconscious fraud in the proprietary accounts of corporations. If the assets minus the liabilities do not exceed the capital stock issued, there is a tendency to correct this result by increasing assets in one way or another, so that the books may make a good showing. Here the division of the ownership among many persons leads to disguising what the real ownership is.

A Fair Statement

But why treat the corporation differently from other enterprises? The answer is found in the par value of the capital stock. Do away with the par

value stock and substitute stock without par value, and you solve this difficulty and some others.

Corporations without a par value to their capital stock are becoming more popular and merit special attention. It does away with the need for arbitrary division of the capital account. There is no necessity of maintaining separately the original contributions of stockholders from capital acquired thru business operations by means of a surplus account. In such a case the capital, as in other business forms, represents the original investment plus the undivided profits. The shares of stockholders are equal portions of the proprietorship.

Cooperative financing in this form of organization is sometimes made more easy when stock can be sold at the market price without any of the formalities of issuance, and return for sale as treasury stock.

How the Business is Owned

If you are in business as a sole proprietor, as a partner or as manager of a corporation, your primary purpose is to make a profit. You will strive to keep your capital intact, and add to it, but if it should be impaired you are accountable only to yourself. If, however, you are in business as a trustee, your primary purpose is not to make profits but to conserve the capital intrusted to you, and it is your duty to account for your handling of the original property as well as of any accretions which may have come to it.

This conditions the form of the accounts, and

the principles underlying them. Therefore the author devotes considerable attention to how the business is owned. He finds this relation of trusteeship in different forms in the handling of consignments, in the settlement of estates, in the management of work of a receiver in bankruptcy, and to each of these subjects a suggestive treatment is given.

Principles Underlie Details

"What you say may be true, but there is nothing in it for me." This is the voice of the turtle who never gets outside his shell but carries his shell with him. Of course there are turtles in business, but they will not be found among the readers of the MODERN BUSINESS Text.

It is distinctly worth while to examine carefully the details of some subjects for the sake of principles which underlie them. You are not asked to learn the details parrot-like, for you may never use them. But it is good to know that the details considered may at times be of infinite importance, and it is better still to know why this is the case. You may not find the same details in your own business, but you will find analogous ones, and you will be better equipped to make them a constructive force for better business.

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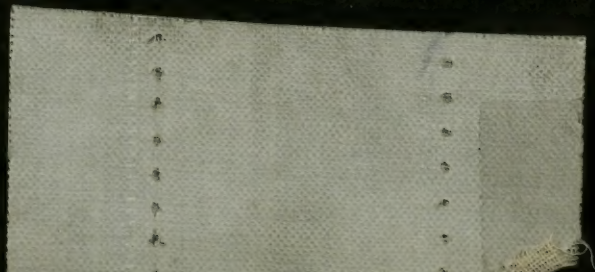

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